Office - Supreme Court, U.S.
FILED
JUL 18 1984
ALEXANDER L. STEVAS
CLERK

No. 83-1715

In the Supreme Court of the United States

OCTOBER TERM, 1984

RICHARD GAJEWSKI, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

REX E. LEE
Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 633-2217

BEST AVAILABLE COPY

TABLE OF AUTHORITIES

Page

Cases:

Bessenyey v. *Commissioner*, 379 F.2d 252, cert. denied, 389 U.S. 931 4

Deputy v. *du Pont*, 308 U.S. 488 ..... 2, 4

Ditunno v. *Commissioner*, 80 T.C. 362 ..... 2, 3, 4, 6

Estate of Cull v. *Commissioner*, 45 T.C.M. (CCH) 691, appeal pending No. 83-1601 (6th Cir.) 3

Gentile v. *Commissioner*, 65 T.C. 1 2

Groetzinger v. *Commissioner*, 82 T.C. No. 61 (May 24, 1984) 3

Higgins v. *Commissioner*, 312 U.S. 212 ..... 2, 3, 5, 6

Moller v. *United States*, 721 F.2d 810, cert. denied, No. 83-1485 (June 18, 1984) 6, 7

Nipper v. *Commissioner*, 47 T.C.M. (CCH) 136, appeal pending, No. 84-3067 (11th Cir.) 3

Snow v. *Commissioner*, 416 U.S. 500 5

Stanton v. *Commissioner*, 399 F.2d 326 4

Statutes:

Internal Revenue Code of 1954 (26 U.S.C. (& 1976 ed.)):

§ 55(b)(1)(B) 7
§ 55(e)(1)(A) 7
§ 56 (1976 ed.) 1
§ 56(a) (1976 ed.) 2

Page

Statutes—Continued:

§ 57(a)(1) (1976 ed.) 2
§ 57(b)(1)(A) (1976 ed.) 2
§ 62(1) (1976 ed.) 2
§ 62(1) 4, 5
§ 162 4
§ 162(a) 5, 6
§ 165(d) 7
§ 174 4
§ 174(a)(1) 5
§ 274(a) 7
§ 280A(c)(1) 4, 7

Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, § 201(a), 96 Stat. 411 7

In the Supreme Court of the United States

OCTOBER TERM, 1984

No. 83-1715

RICHARD GAJEWSKI, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

Petitioner challenges the court of appeals' holding that his gambling activities did not constitute a "trade or business" for purposes of the minimum tax on tax preferences. The decision below is correct. Petitioner does not allege (nor is there) a conflict among the circuits on the question presented. There is no basis for review by this Court.

1. Petitioner was a full-time gambler during 1976-1977. His only source of income was pari-mutuel wagering on jai-alai (Pet. App. 609). He bet solely for his own account and did not act as a bookmaker or hold himself out in any way as offering goods or services to others (*ibid.*). He incurred gambling losses equal to or in excess of his gambling winnings in both years (*id.* at 610).

Section 56 of the Internal Revenue Code, as it existed during the tax years at issue, imposed a minimum tax on persons whose "items of tax preference" exceeded certain

amounts (26 U.S.C. (1976 ed.) 56(a)). Section 57(a)(1) defined "items of tax preference" to include "excess itemized deductions" (26 U.S.C. (1976 ed.) 57(a)(1)). Gambling losses are generally itemized deductions. Under Section 57(b)(1)(A), however, "excess itemized deductions" for minimum tax purposes were defined to exclude "deductions allowable in arriving at adjusted gross income" (26 U.S.C. (1976 ed.) 57(b)(1)(A)). Section 62(1) provides that deductions allowable in arriving at adjusted gross income — often called "above the line" deductions — include deductions "attributable to a trade or business carried on by the taxpayer" (26 U.S.C. (1976 ed.) 62(1)).

The Commissioner determined that petitioner was not engaged in the "trade or business" of gambling and hence that his gambling losses were not deductions of the sort described in Section 62(1). In so concluding, the Commissioner relied on *Gentile* v. *Commissioner,* 65 T.C. 1 (1975), which held that a taxpayer who gambles solely for his own account is not in a "trade or business" because he does not hold himself out to others " 'as engaged in the selling of goods or services' " (65 T.C. at 5, quoting *Deputy* v. *du Pont,* 308 U.S. 488, 499 (1940) (Frankfurter, J., concurring)). Based on this conclusion, the Commissioner determined that some of petitioner's gambling losses represented "excess itemized deductions," that those excess deductions were "items of tax preference," and that petitioner was therefore liable for minimum tax.

Petitioner sought redetermination of the resulting deficiency in the Tax Court. While his petition was pending, the Tax Court overruled *Gentile* in *Ditunno* v. *Commissioner,* 80 T.C. 362 (1983). In *Ditunno,* the majority[1] noted that, under *Higgins* v. *Commissioner,* 312 U.S. 212 (1941),

---

[1]Judge Tannenwald, the author of *Gentile,* dissented in *Ditunno,* joined by three other judges (80 T.C. at 372-377).

"[t]he proper test of whether an individual is carrying on a trade or business requires an examination of all the facts involved in each case" (80 T.C. at 366-367 (emphasis omitted)). Under this "facts and circumstances test," the *Ditunno* court concluded, the "failure to provide or offer goods and services [should] not [be] sufficient by itself to find that a taxpayer is not carrying on a trade or business" (80 T.C. at 370 (footnote omitted)). This reasoning was based largely on a series of cases which, like *Higgins,* had involved investors in securities and which had ascertained those taxpayers' trade-or-business status by inquiring whether they were "traders" rather than mere "investors," without specifically inquiring whether they offered goods or services (80 T.C. at 370-371). Applying this "facts and circumstances test," the Tax Court in *Ditunno* held that a full-time gambler is engaged in a "trade or business" for minimum tax purposes by virtue of the frequency and regularity of his activities (80 T.C. at 371-372), and the Tax Court similarly concluded that "*Ditunno* control[led]" its decision here (45 T.C.M. (CCH) 967, 968 (1983)). It accordingly held that petitioner's gambling losses were not "items of tax preference" subject to minimum tax.[2]

The Second Circuit unanimously reversed. The words "trade or business," it observed, are "commonly viewed as meaning a commercial activity in which a person seeks to

---

[2]Because of a procedural problem, the Commissioner was precluded from appealing the Tax Court's decision in *Ditunno.* The Commissioner has appealed two subsequent Tax Court decisions that followed *Ditunno,* both of which present the same question as *Ditunno* and this case, viz., the liability of a gambler for minimum tax. *Estate of Cull* v. *Commissioner,* 45 T.C.M. (CCH) 691 (1983), appeal pending, No. 83-1601 (6th Cir. 1983); *Nipper* v. *Commissioner,* 47 T.C.M. (CCH) 136 (1983), appeal pending, No. 84-3067 (11th Cir. 1984). Neither case has yet been argued. In *Groetzinger* v. *Commissioner,* 82 T.C. No. 61 (May 24, 1984), the Tax Court declined to depart from the position it took in *Ditunno,* notwithstanding its reversal by the Second Circuit in this case. Appeal in *Groetzinger* would lie to the Seventh Circuit.

earn a livelihood by furnishing goods or services to others for a price" (Pet. App. 616). It noted that the courts of appeals, as well as the Tax Court before *Ditunno,* have typically regarded the offer of goods or services as a prerequisite to being in a "trade or business" for tax purposes (*id.* at 613-615). And it concluded that this requirement not only describes "the universal characteristic of a business man or trader in a free enterprise society," but also offers a standard that is "administratively workable and fair to taxpayers" (*id.* at 616, 617). Because petitioner "gambled only for his own account and did not operate a bookmaking service or place wagers for others," he was not engaged in a "trade or business" and his gambling losses were thus items of tax preference subject to minimum tax (*id.* at 617).

2. The decision below is correct. The phrase "trade or business," while appearing frequently in the Internal Revenue Code,[3] is defined neither in the Code nor in the regulations, and the courts have thus been left to develop its meaning on a case-by-case basis. The courts have identified several requirements that a taxpayer must meet to be engaged in a "trade or business" for tax purposes, including the requirement that his activities be regular and continuous (*e.g., Stanton* v. *Commissioner,* 399 F.2d 326 (5th Cir. 1968)) and that they be undertaken to make a profit (*e.g., Bessenyey* v. *Commissioner,* 379 F.2d 252 (2d Cir.), cert. denied, 389 U.S. 931 (1967)). Still another requirement — that the taxpayer hold himself out to others as offering goods or services — "finds its genesis," as the court below put it (Pet. App. 613), in Justice Frankfurter's concurring opinion in *Deputy* v. *du Pont,* 308 U.S. 488, 499 (1940). Since then, this so-called "goods or services" requirement

---

[3] *E.g.,* I.R.C. §§ 62(1) (adjustments to gross income), 162 (trade or business expenses), 174 (research expenses), 280A(c)(1) (home-office deductions).

has received general acceptance in the lower courts (see Pet. App. 615 (citing cases)).

Although this Court has never had occasion explicitly to address the "goods or services" requirement, the Court implicitly approved that formula in *Snow* v. *Commissioner*, 416 U.S. 500 (1974). The question there was the proper construction of Section 174(a)(1), which allows a deduction for research expenses incurred "in connection with [a] trade or business." The Court held that the "goods or services" requirement did not apply to Section 174(a)(1), contrasting it in that respect with Section 162(a), which allows a deduction for expenses incurred "in carrying on any trade or business." The Court noted that Section 162(a) is "more narrowly written" than Section 174(a)(1) — since it uses the words "in carrying on" rather than "in connection with" — and remarked (416 U.S. at 502-503):

> Section 174 was enacted * * * to dilute some of the conception of "ordinary and necessary" business expenses under § 162(a) * * * adumbrated by Mr. Justice Frankfurter in a concurring opinion in *Deputy* v. *DuPont*, * * * where he said that the section in question * * * "involves holding one's self out to others as engaged in the selling of goods or services."

This case concerns Section 62(1), which, like Section 162(a), requires "carrying on" a trade or business. The "goods or services" requirement was thus properly applied here as a threshold test for determining whether petitioner was so engaged.

3. Contrary to petitioner's contention (Pet. 5-11), the decision below does not conflict with this Court's decision in *Higgins* v. *Commissioner*, 312 U.S. 212 (1941), nor does it reject what petitioner describes (Pet. 7) as the *Higgins* "facts and circumstances test." The question there was whether expenses incurred by an investor in managing a

large securities portfolio were deductible as trade-or-business expenses under the predecessor of Section 162(a). This Court held that they were not, reasoning that personal portfolio-management is not a "trade or business" regardless of the extent of a taxpayer's wealth or the amount of time expended (312 U.S at 218). The Court did note in *Higgins* (*id.* at 217) that "[t]o determine whether the activities of a taxpayer are 'carrying on a business' requires an examination of the facts in each case." But the court of appeals here did examine the facts of this case, holding that petitioner was not in a "trade or business" because he bet solely for his own account and did not offer services to others.

As we noted recently in *Moller* v. *United States,* 721 F.2d 810 (Fed. Cir. 1983), cert. denied, No. 83-1485 (June 18, 1984), the so-called "facts and circumstances test" that petitioner and other taxpayers have sought to derive from *Higgins* is not really a test at all, for it embodies no substantive legal standard (Br. in Opp. 12).[4] "Once the facts and circumstances are ascertained," the court noted correctly below (Pet. App. 616), "there remains the problem of deciding upon a fair and reasonable standard for determining whether the taxpayer is engaged in a trade or business." Nothing in *Higgins* forecloses the "goods or services" requirement, or any of the other requirements developed by the lower courts, as elements of that standard.[5]

---

[4]A copy of our brief in *Moller* is being sent to petitioner's counsel.

[5]There is no merit to the suggestion, advanced by the Tax Court in *Ditunno* (80 T.C. at 370-371), that the "goods or services" requirement is inconsistent with cases which have ascertained the trade-or-business status of securities investors by inquiring whether they are "traders." The "trader versus investor" test grew out of this Court's analysis in *Higgins,* and its particular formulation probably owes to the fact that *Higgins* involved an investor in securities. It is consistent with the "goods or services" requirement because, as noted below (Pet. App. 617

4. Petitioner does not allege, nor is there, a conflict among the circuits on the question presented. Indeed, the Second Circuit below is the first court of appeals to consider the question whether gambling losses are "items of tax preference" for purposes of the minimum tax. As noted above (see page 3 note 2, *supra*), appeals raising this question are now pending in several other circuits. It will be time enough for this Court to consider the issue when and if a conflict develops.[6]

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

REX E. LEE
Solicitor General

JULY 1984

---

n.8), a securities trader holds himself out to others as offering "goods," *i.e.*, stocks and bonds. The Court recently denied certiorari in *Moller* v. *United States*, No. 83-1485 (June 18, 1984), despite the taxpayers' protestations that cases employing the "goods or services" test conflict with those employing the "trader versus investor" test.

[6]Although the question whether a gambler is engaged in a "trade or business" may arise in other contexts — *e.g.*, the deductibility of travel (I.R.C. § 274(a)) or home-office (I.R.C. § 280A(c)(1)) expenses — the narrow question presented here has been resolved legislatively for years beginning after 1982. For those years, gambling losses deductible under Section 165(d) are specifically excluded from the minimum tax base. See I.R.C. § 55(b)(1)(B) and (e)(1)(A) (as amended by Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, § 201(a), 96 Stat. 411).

DOJ-1984-07